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No. 00 - 1454

In the
Supreme Court of the United States

TEXTRON FUNDING CORP. *ET AL.*,
Petitioners,
v.
CHERYL BESSETTE,
Respondent.

On Petition for Writ of *Certiorari* to the United States Court of Appeals for the First Circuit

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BRIEF OF *AMICUS CURIÆ* NEW ENGLAND LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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MOTION OF *AMICUS CURIAE* NEW ENGLAND LEGAL FOUNDATION FOR LEAVE TO FILE BRIEF IN SUPPORT OF PETITIONER

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Pursuant to Supreme Court Rule 37.2, counsel for *Amicus Curiae*, who is employed by the New England Legal Foundation, have attempted to secure written consent for the filing of the attached Brief *Amicus Curiae* from counsel for the Petitioners and Respondents. Although counsel for Petitioners granted such consent, counsel for Respondents withheld it. Accordingly, counsel for *Amicus Curiae* hereby moves this Court for leave to file the Brief *Amicus Curiae* which is submitted herewith. *Amicus* makes this motion on the following grounds:

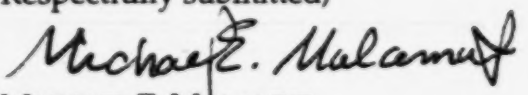
Amicus curiæ New England Legal Foundation ("NELF"), a non-profit, public interest law firm, was incorporated in 1977. Its membership consists of individuals, businesses, and others who believe in promoting balanced economic growth for New England, protecting the free enterprise system, and defending economic rights. NELF's more than 130 members and supporters include a cross-section of large and small businesses from all parts of New England and the United States. NELF has regularly appeared in state and federal court, as party or counsel, in cases raising issues of general economic significance to the business community. *See, e.g., Palazzolo v. Rhode Island*, No. 99-2047 (U.S. argued February 26, 2001); *Crosby v. National Foreign Trade Council*, 530 U.S. 363 (2000); *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358 (1999); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996); *BMW v. Gore*, 517 U.S. 559 (1996); *Estados Unidos Mexicanos v. DeCoster*, 229 F.3d 332 (1st Cir. 2000); *Reich v. Southern New England Telecommunications Corp.*, 121 F.3d 58 (2d Cir. 1997); *Georgine v. Amchem Products, Inc.*, 83 F.3d 610 (3d Cir. 1996); *Conservation Law Foundation v. Department of the Air Force*, 79 F.3d 1250 (1st Cir. 1996); *Preseault v. United States*, 66 F.3d 1167 (Fed. Cir. 1995); *B.F. Goodrich Co. v. Murtha*, 958 F.2d 1192 (2d Cir. 1992). NELF served as *amicus curiæ* supporting the position of Petitioner in this matter at the Court of Appeals for the First Circuit below.

Amicus seeks to bring to the Court's attention its views, and those of its supporters, concerning the effect of the decision below on the availability of secured financing at reasonable rates to consumers. In addition, NELF's members

are affected by the business climate, which is strongly affected by the ability of retail businesses to sell goods subject to secured interests. Furthermore, some of NELF's members are directly interested in the issue of consumer credit financing because they are involved in lending to consumers, in manufacturing consumer products, and in selling goods at retail. A healthy retail sales climate is a mark of a vital and vibrant economy. For those reasons, and because the ready availability of secure consumer credit fuels a thriving economy, NELF's members are concerned about the issues presented this case. If the opinion of the Court of Appeals below is not reversed, the availability of consumer finance on reasonable terms may be reduced and the interest rates for secured consumer transactions increased. *Amicus* believes that this brief may provide an additional perspective which may aid the Court in determining whether to grant the petition for a writ of *certiorari*.

Wherefore, NELF respectfully requests that this Court grant *Amicus Curiae* leave to file the attached brief in support of the Petition for a Writ of *Certiorari*.

Respectfully submitted,



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Dated: April 18, 2001

QUESTIONS PRESENTED

Is the remedy of a debtor, represented by counsel, who fully pays reaffirmed debt so as to retain the collateral, but nevertheless alleges injury from the collection of a discharged debt because of the failure to comply with the statutory requirements for an enforceable reaffirmation agreement, a contempt proceeding before the bankruptcy court that issued the discharge or does Section 105 of the Bankruptcy Code create a substantive implied cause of action for damages, which may be brought as a putative class action in any federal court where the creditor may be served?

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BRIEF OF *AMICUS CURIÆ* NEW ENGLAND LEGAL FOUNDATION IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIÆ*

Amicus curiæ New England Legal Foundation ("NELF"), a non-profit, public interest law firm, was incorporated in 1977.[1] Its membership consists of individuals, businesses, and others who believe in promoting balanced economic growth for New England, protecting the free enterprise system, and defending economic rights. NELF's more than 130 members and supporters include a cross-section of large and small businesses from all parts of New England and the United States. NELF has regularly appeared in state and federal court, as party or counsel, in cases raising issues of general economic significance to the business community. *See, e.g., Palazzolo v. Rhode Island*, No. 99-2047 (U.S. argued February 26, 2001);

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1 Pursuant to Supreme Court Rule 37.6, counsel for *amicus* states that counsel for neither Petitioner nor Respondent authored the accompanying brief in whole or in part and no person or entity other than *amicus* made a monetary contribution to the preparation or submission of the brief.

Crosby v. National Foreign Trade Council, 530 U.S. 363 (2000); *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358 (1999); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996); *BMW v. Gore*, 517 U.S. 559 (1996); *Estados Unidos Mexicanos v. DeCoster*, 229 F.3d 332 (1st Cir. 2000); *Reich v. Southern New England Telecommunications Corp.*, 121 F.3d 58 (2d Cir. 1997); *Georgine v. Amchem Products, Inc.*, 83 F.3d 610 (3d Cir. 1996); *Conservation Law Foundation v. Department of the Air Force*, 79 F.3d 1250 (1st Cir. 1996); *Preseault v. United States*, 66 F.3d 1167 (Fed. Cir. 1995); *B.F. Goodrich Co. v. Murtha*, 958 F.2d 1192 (2d Cir. 1992). NELF served as *amicus curiæ* supporting the position of Petitioner in this matter at the Court of Appeals for the First Circuit below.

Amicus seeks to bring to the Court's attention its views, and those of its supporters, concerning the effect of the decision below on the availability of secured financing at reasonable rates to consumers. In addition, NELF's members are affected by the business climate, which is strongly affected by the ability of retail businesses to sell goods subject to secured interests. Furthermore, some of NELF's members are directly interested in the issue of consumer credit financing because they are involved in lending to consumers, in manufacturing consumer products, and in selling goods at retail. A healthy retail sales climate is a mark of a vital and vibrant economy. For those reasons, and because the ready availability of secure consumer credit fuels a thriving economy, NELF's members are concerned about the issues presented this case. If the opinion of the Court of Appeals below is not reversed, the availability of consumer finance on reasonable terms may be reduced and the interest rates for secured consumer transactions increased. *Amicus* believes that this brief may provide an additional perspective which may aid the Court in determining whether to grant the petition for a writ of *certiorari*.

STATEMENT OF THE CASE

Amicus adopts the Statement of the Case contained in the Brief of the Petitioners, Avco Financial Services, Inc., *et al.*, now known as Textron Funding Corp. *et al.* ("Avco").

SUMMARY OF ARGUMENT

Amicus argues that neither the Court of Appeals for the Seventh Circuit nor the Court of Appeals for the Sixth Circuit, both of which have addressed the issue of the appropriate remedy for violations of reaffirmation filing procedures, have found a substantive remedy for such violations in 11 U.S.C. § 105 ("Section 105"). The decision of the Court of Appeals for the First Circuit, finding a substantive remedy in Section 105 in the case below, is therefore at variance with the decisions of the majority of the Courts of Appeals that have dealt with this issue. (pp. 3–10). *Amicus* further contends that public policy militates against a substantive remedy for reaffirmation filing violations. A substantive remedy would encourage bankrupt debtors to attempt to retain secured collateral without payment, causing disruption to the secured credit system that allows for lower consumer interest rates. (pp. 10–12).

ARGUMENT

I. THIS CASE INVOLVES AN IMPORTANT QUESTION OF UNSETTLED FEDERAL LAW THAT SHOULD BE RESOLVED BY THIS COURT.

This Court should grant the petition for *certiorari* to the Court of Appeals for the First Circuit to review of the decision below, *Bessette v. Avco Financial Services*, 230 F.3d 439 (1st Cir. 2000). *Amicus* NELF supports and adheres to the position of Petitioner Avco on the substantive and procedural issues raised in its Petition for Writ of *Certiorari*. In addition, NELF contends that a review of the facts of this case, considered in light of common sense and ordinary business experience, underscores the inappropriateness of a substantive remedy

under 11 U.S.C. § 105 for failure to file reaffirmation agreements. In light of the conflict among the circuits regarding the remedy for unfiled reaffirmation agreements and the extent to which this issue is a nationwide concern to many large-scale creditors, this case qualifies for Supreme Court review. SUP. CT. R. 10 (a) (*certiorari* warranted when "a United States court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter . . . ."). *Compare Bessette with Cox v. Zale Delaware, Inc.*, 239 F.3d 910 (7th Cir. 2001), *and Pertuso v. Ford Motor Cred. Co.*, 233 F.3d 417 (6th Cir. 2000).

Respondent Cheryl Bessette ("Bessette") purchased a bedroom set from Cardi's Furniture on December 26, 1994, with a secured loan from Petitioner Avco. Petition at 2. The original amount of the loan was $2015.66 at 21% interest. App. at 118. Only nine months later, Bessette signed a reaffirmation agreement for $1500.00 at only 12% interest, 9% lower than the original loan amount. App. at 124. The reaffirmation agreement included language indicating that Bessette could rescind the reaffirmation agreement within 60 days and was signed by her attorney. App. at 124–25. The agreement did not, however, contain a statement indicating that Bessette was not required to reaffirm.[2] *Id.* The agreement was not filed with the court as required by 11 U.S.C. § 524 ("Section 524"). App. at 95. Bessette retained, and apparently continued to use,

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2 In 1994, Section 524 (c) (2) was again amended by adding a requirement that reaffirmation agreements include a statement advising the debtor that the agreement is not required. Pub. L. No. 103-394, 108 Stat. 4108 (1994). The National Bankruptcy Review Commission, however, denigrated the value of the mandated language, referring to it as "boilerplate." NATIONAL BANKRUPTCY REV. COMM'N, *BANKRUPTCY: THE NEXT TWENTY YEARS* 151 (1997) (indicating that this new requirement was a "*modest* change[] to the *boilerplate* disclosure requirements" (emphasis added)). Bessette's attorney signed a declaration indicating that he had informed her fully of her rights as required by Section 524 (c) (3). App. at 125.

the bedroom set.

The division among the circuits regarding the legal implications of this scenario appears to rest largely on the attitude of the respective courts towards participants in this typical reaffirmation situation. NELF contends that the Court of Appeals for the Seventh Circuit more accurately captures the reality of the typical reaffirmation:

> [T]he debtor . . . represented by counsel when he signed the reaffirmation agreement, made the payments called for by the agreement voluntarily. He wanted to hold on to the property that he would have lost had the creditor repossessed the property to enforce its lien in it . . . . *The violation of section 524 (c) was thus technical, trivial, and arguably, indeed, condoned* and hence no violation at all, and certainly not the sort of thing that would warrant a proceeding for contempt.

Cox, 239 F.3d at 915 (emphasis added). *See Pertuso*, 233 F.3d at 424–25.[3]

The Court of Appeals for the First Circuit, on the other hand, apparently views the conduct of a creditor that fails to

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3 [The debtors] were represented by an attorney, . . . had previously stated their intent to reaffirm the debt, . . . the reaffirmation agreement was reasonable on its face, and . . . [the creditor] was not guilty of harassment. If the [debtors] were interested in knowing whether the agreement had been filed, it would have been simple enough for them or their attorney to find out. Viewed as a whole, the facts alleged . . . *simply do not evince conduct that is "contrary to what a reasonable person would consider to be fair under the circumstances."*

Pertuso, 233 F.3d at 424–25 (citations omitted) (emphasis added), *quoting In re Briggs*, 143 B.R. 438, 453 (Bankr. E.D. Mich. 1992).

file a reaffirmation agreement signed by debtor's counsel as a serious violation of consumer protection: "This appeal involves the wrongful, and supposedly common, practice by certain creditors of coercing naive and inexperienced debtors into reaffirming debt that has been properly discharged in bankruptcy." *Bessette*, 230 F.3d at 442. Despite the outraged introduction by the First Circuit, dispassionate review of the circumstances of *Bessette*, *Cox*, and *Pertuso* reveals that in each case: (1) there was, in fact, no discussion in the appellate opinion of coercion of the debtor; (2) the debtors were represented by counsel, who were charged with advising their supposedly "naive and inexperienced" clients in order to overcome these alleged deficiencies; and (3) the debtors retained the collateral.

Moreover, in reality, to the extent that the filing of reaffirmation agreements approved by debtors' counsel may have been intended to protect debtors, in the flood of filings and burgeoning bankruptcy caseloads, such agreements tended to receive no review or at most *pro forma* review.[4] Prior

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4 It is, in fact, not at all clear that the obligation to file the reaffirmation agreement rests with the creditor. Section 524 (c) (3) is silent as to who is to file. It t has long been accepted that only the debtor has the right to apply for approval of a reaffirmation agreement. *Arnhold v. Kyrus*, 851 F.2d 738, 742 (4th Cir. 1988); *In re Pertuso*, No. 98-CV-70551-DT, 1998 U.S. Dist. LEXIS 21191, at *8–9 (E.D. Mich. Dec. 30, 1998) ("In fact, a messenger can file the agreement for both sides. Neither party should be penalized for failing to file the agreement."), *aff'd*, 233 F.3d 417 (6th Cir. 2000); *In re Kamps*, 217 B.R. 836, 843–44 (Bankr. C.D. Cal. 1998); *In re Carlos*, 215 B.R. 52, 61 (Bankr. C.D. Cal. 1997); *In re Newsome*, 3 B.R. 626, 628–29 (Bankr. W.D. Va. 1980). The *Kamps* court strongly advises creditors to file reaffirmation agreements, but the court makes it clear that burden of ensuring the approval of the reaffirmation lies primarily with the debtor. *In re Kamps*, 217 B.R. at 844. *See* Karen Gross, *Perceptions and Misperception of Reaffirmation Agreements*, 102 COM. L.J. 339, 341 n.14 (1997). When the burden of filing the reaffirmation agreement at least arguably lies primarily with the debtor and the

to 1996, the Rhode Island Bankruptcy Court did not even cursorily review the terms of reaffirmation agreements approved by debtor's counsel. *In re Grinnell*, 170 B.R. 495, 496 (Bankr. D.R.I. 1994). Subsequently, the same court held that, although Section 524 (c) (3) "eliminated the requirement of court approval as to agreements containing attorney affidavits," it would thereafter internally review attorney approved reaffirmations. *In re Izzo*, 197 B.R. 11, 12 & n.2 (Bankr. D.R.I. 1996). Thus, while Bessette's reaffirmation, if filed, might have received a cursory review by the bankruptcy court, from the information in the record there is no reason to believe that the court would have had any reason to question an attorney-approved agreement based on a secured interest in substantial furniture with a lower interest rate than the original loan. *See* App. at 124.

By finding a cause of action in 11 U.S.C. § 105 for this alleged harm to debtors, the *Bessette* court pushes Section 105 beyond its plain meaning as a source of procedural (not substantive) remedies and ignores the true nature of this case, as explained in *Cox*:

> [The debtor's] lawyer could have advised him that, the debt having been discharged, [the debtor] didn't have to keep paying [the creditor]—though the consequence of not paying might be that [the creditor] would repossess the [collateral]. [The creditor] might not be able to enforce [the debtor's] agreement to pay it . . . , but it could enforce its security interest, which the order of discharge had not touched. . . . [T]he stakes in this case are negative—that [the debtor] would be worse off if he won than if he lost—since if he can get

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debtor is represented by counsel, it seems harsh to characterize the creditor that relies on the reaffirmation agreement as "coercing [a] naive and inexperienced debtor[]" as the *Bessette* court would have it. 230 F.3d at 442.

> his [post-discharge payment] back, [the creditor] can get the [collateral] back, together with the rental value of the [collateral] during the period since [the creditor], by signing the debt-reaffirmation agreement, forwent its right to repossess it.

Cox, 239 F.3d at 915–16.

Cox recognizes the practical implications of the typical straightforward reaffirmation agreement and the relatively *pro forma* nature of reaffirmation review, especially when debtors are represented by counsel. While the reaffirmation procedures originally enacted in 1978 had required a discharge hearing in every case (regardless of whether the debtor was represented by counsel), they proved unduly costly and burdensome. *See* S. REP. NO. 98-65 at 59–60 (1983). The process for debtors represented by counsel, such as Bessette, was therefore streamlined by the 1984 Bankruptcy Amendments and Federal Judgeship Act, which allowed reaffirmation agreements by debtors represented by counsel to be approved without a hearing if a detailed affidavit of counsel was filed. Pub. L. No. 98-353, 98 Stat. 354 (1984); NATIONAL BANKRUPTCY REV. COMM'N, *BANKRUPTCY: THE NEXT TWENTY YEARS* 151 (1997); S. REP. NO. 98-65 at 59–60 (1983) ("[T]he new section is designed to encourage the prompt execution of good faith reaffirmation agreements *by eliminating the cumbersome and unnecessary prior approval procedures which inhibited debtors and creditors from consummating mutually acceptable debt retirement arrangements.*" (emphasis added)).

The Reporter for the National Bankruptcy Review Commission acknowledged that, even after the 1984 reforms, the reaffirmation procedures remain complex and burdensome. Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AMERICAN BANKR. L.J. 483, 500–01 (1997). The purpose of the complexity of Section 524 (c), however, is not to trip up creditors acting in good faith so that debtors can retain collateralized goods without payment, as

appears to be urged by Bessette, but rather to balance carefully debtors' procedural protections with debtors' desire to retain collateralized goods.

This case and the *Pertuso* case, taken together, demonstrate the importance of resolving the dispute among the circuits concerning the rights of the parties when a reaffirmation agreement is not filed. The debtors in *Pertuso* are Rhode Island residents, as is the debtor in *Bessette*. The transactions in question are similar, reaffirmations of secured debt (in *Pertuso* a van, in *Bessette* a bedroom set) made with the advice of counsel but never filed with the Bankruptcy Court, and both cases were initiated with the intent of starting a class action to capitalize on the failure of creditors to file reaffirmation agreements. Because the creditor in *Pertuso* was headquartered in Michigan, suit was brought there and ultimately found meritless by the Court of Appeals for the Sixth Circuit. *Bessette* was brought in the First Circuit, which now holds that a remedy beyond traditional contempt can be pursued for such violations based on 11 U.S.C. § 105—two Rhode Island debtors, two vastly different results. *See Pertuso*, 233 F.3d at 424. Given the national nature of consumer finance and the federal nature of bankruptcy, it is inevitable that, unless this Court resolves the difference among the circuits, failure-to-file-reaffirmation-agreement class actions will be brought whenever possible within the First Circuit as Section 105 claims. The occasional and rare individual claimant outside the First Circuit who mistakenly sues in another circuit will be denied substantial relief, because the majority of other circuits that have considered the issue hold that the remedy, if any, is a contempt hearing in the court that supervised the bankruptcy proceeding. On the other hand, other debtors—who by fortuity borrowed from creditors sued by well connected class action attorneys who file in the First Circuit—will reap the benefits of class action suits and settlements despite retaining their collateral. This is exactly the type of situation that Supreme Court Rule 10 (a) addresses

in recognizing the importance of resolving inter-circuit differences.

II. THE COURT OF APPEALS FAILED TO TAKE INTO ACCOUNT ADVERSE PUBLIC POLICY IMPLICATIONS.

The only way that the *Bessette* court can fail to reach a similar conclusion to that of *Cox* and *Pertuso*—that collecting on an unfiled reaffirmation agreement when the debtor retains the collateral is at most a technical violation—is to hypothesize that debtors will typically be able to retain secured collateral without any payment whatsoever.[5] Much secured debt is undersecured. *Cox*, 239 F.3d at 912. In the individual case, it is rarely worth the legal, transportation, and other transactional costs to repossess secured collateral that can only be resold at a discount as used goods. Therefore, in the individual case, the debtor owning collateral subject to a security interest might well gamble on keeping the collateral without fear of repossession. A court inclined to this type of analysis might feel that the creditor receives a windfall if the debtor repays the debt: after all, in retrospect, the debtor might have kept the collateral without making payments on the reaffirmation agreement. Viewed with that jaundiced eye, it may seem unfair to require debtors who retain secured collateral to pay their secured debts post-discharge. Only seen in this light does the *Bessette* opinion make any sense.

Looked at in the broader context, however, without the benefit of retrospective hypotheticals, in many cases creditors do repossess undersecured collateral, even when the costs of doing so exceed any possible benefits to the creditor. The reason for this is to uphold the validity of the secured debt system. Secured debt allows consumers to purchase goods for

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5 The *Bessette* court does not imply that the reaffirmation agreement itself is any way unfair. In fact, the interest rate is significantly lower than on the original loan agreement. App. at 118, 124.

lower interest rates and, for those with marginal credit histories, oftentimes to purchase needed household goods at all. Like the tax system, the secured debt system will only work if the majority of the participants voluntarily comply with their obligations. Congress recognized that reality when it established special protections for secured debt in bankruptcy proceedings. *See* 11 U.S.C. § 521. Enforcement is required to retain the integrity of the system, even if it may not make financial sense in the particular case viewed independently. If, following the implicit logic of *Bessette*, debtors were encouraged to repudiate their secured debts and hope that their creditors would not repossess, the trust inherent in the secured debt system would collapse under the sheer number of uncollectible secured claims. To the extent that the protections of secured debt are thus whittled away and secured debt begins to approximate more closely unsecured debt, the benefits to debtors inherent in secured debt—lower interest rates and increased credit availability—will be diminished.

Thus, as a matter of public policy, harsh sanctions in the form of a class action recovery under 11 U.S.C. § 105, with the potential for punitive damages, would discourage creditors from entering into reaffirmation agreements, thereby (1) destroying the carefully constructed Congressional balance to encourage good faith reaffirmation agreements, and (2) making creditors less likely to enter into secured credit agreements, with their considerable benefits to the typical consumer. S. REP. NO. 98-65 at 59-60 (1983). While Bessette and the *Bessette* court apparently feel that a new substantive cause of action for violations of the technical requirements of Section 524 (c) will result in more abandonment of collateralized goods to debtors, it might well result instead in more repossessions of goods essential to debtors such as their cars, vans, refrigerators, washing machines, jewelry, and bedroom sets. A right of action under Section 105 would result in a windfall to plaintiffs who would likely retain—without

payment for use—their property, while doing little to effectuate better compliance with reaffirmation requirements. Allowing such litigation would likely increase the cost of financing goods for all consumers,[6] and thus serve as a disincentive for consumers contemplating purchases on credit, with an adverse impact on the consumer-driven economy. An increase in interest rates for secured purchases is more likely to harm those of moderate means than an occasional violation of the reaffirmation protections that may be readily vindicated through traditional contempt proceedings if warranted.

All of Avco's conduct, taken together, seems more like sloppy bookkeeping than a deliberate policy of ignoring important procedural safeguards in order to take advantage of debtors like Bessette who were represented by counsel. Bessette, however, aided by the decision below, seeks to take advantage of these largely technical violations in order to receive all the benefits of her bargain without paying any of the costs. This basic unfairness and the adverse public policy effects that flow from it counsel in favor of granting a writ of *certiorari* in this case.

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6 *See In re Edwards*, 901 F.2d 1383, 1386 (7th Cir.1990); Michael P. Alley, Comment, *Redemption, Reaffirmation, Exemption, and Retention in Chapter 7 Bankruptcy: Extinction Looms Near for the Free Ride*, 47 KAN. L. REV. 683, 733 & n.452 (1999) ("[S]ome proponents of the inclusive position [on retention under Section 521 (2) (C)] suggest that creditors should request larger downpayments or *raise interest rates to cover the risks of retention.*" (emphasis added)). See NATIONAL BANKRUPTCY REV. COMM'N, *Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners* at 37.

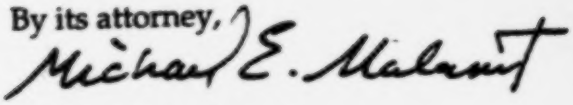
CONCLUSION

For the reasons stated above, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

NEW ENGLAND LEGAL FOUNDATION,

By its attorney,



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Dated: April 18, 2001